Decision 03-06-074 June 19, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish Policies and Cost Recovery Mechanism for Generation Procurement and Renewable Resource Development.	Rulemaking 01-10-024 (Filed October 25, 2001)

ORDER DENYING THE REHEARING OF D.02-09-053

I. SUMMARY

This decision denies the rehearing applications by Southern California Edison Company (SCE), Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), and Sempra Energy Resources (Sempra) of Interim Opinion D.02-09-053 ("Contract Allocation Decision"). The Contract Allocation Decision adopted an allocation system under which the energy utilities were ordered to assume all of the operational, dispatch, and administrative functions for power purchase contracts entered into by the Department of Water Resources (DWR), pursuant to Assembly Bill (AB) X1-1, as of January 1, 2003. The DWR contracts were allocated to the resource portfolios of the three utilities to be scheduled and dispatched in a least-cost manner. The utilities were also ordered to submit Operating Agreements with DWR for Commission review and approval.

As of December 19, 2002, when the Commission issued D.02-12-069 (Operating Order Decision), the utilities were unsuccessful in their attempts to reach a consensus on Operating Agreements with DWR. D.02-12-069 therefore adopted an Operating Order under which the major investor-owned electric utilities will perform operational, dispatch, and administrative functions for the DWR power purchase

contracts. PG&E and SDG&E timely filed rehearing applications of the Operating Order Decision. A separate order is being issued disposing of those applications.

II. FACTS/PROCEDURAL BACKGROUND

Due to the energy crisis, the utilities were not financially able to meet their customers' needs. Therefore, on January 31, 2001, the Legislature authorized the California Department of Water Resources (DWR) in Assembly Bill (AB) X1-1 to make electricity purchases to sell electricity to utility retail customers. This resulted in DWR ultimately managing thirty-five long-term contracts, ranging in term from two to twenty years. Under Water Code §80260, DWR's authority to contract for these purchases expired on January 1, 2003, the date on which the utilities were required to resume procurement.

On October 29, 2001, the Commission initiated Rulemaking (R.) 01-10-024 to establish ratemaking mechanisms and procedures to enable the utilities to resume procuring power for their customers in order to fulfill their obligation to serve. The rulemaking also provided for the consideration of proposals on how the Commission should comply with Public Utilities (PU) Code §701.3.[1] As contemplated in the April 2 Scoping Memo, the Commission adopted the "operational approach," whereby specific contracts are allocated to the utilities to manage as an integral component of their resource portfolios.

On September 19, 2002, the Commission adopted the Contract Allocation Decision, which adopted the operational allocation approach under which the utilities are responsible for integrating the scheduling and dispatch of specific DWR contracts allocated to them with their existing generation assets, contracts and new procurements.[2]

[1] PU Code §701.3 provides that "[u]ntil the commission completes an electric generation procurement methodology that values the environmental and diversity costs and benefits associated with various generation technologies, the commission shall direct that a specific portion of future electrical generating capacity needed for California be reserved or set aside for renewable resources." (Stats. 1991, Ch. 1023, Sec. 2.) Hereinafter, all references to the Code are to the Public Utilities Code, unless otherwise indicated.

[2] D.02-09-053 was approved on September 19, 2002, and mailed on September 23, 2002.

The utilities are required to perform all of the day-to-day scheduling and dispatch functions for the DWR contracts allocated to their portfolios, including administrative functions. The Contract Allocation Decision also ordered the utilities to file jointly proposed Operating Agreements with DWR for Commission review and approval.[3]

On October 16, 2002, SCE timely filed an application for the rehearing of D.02-09-053. PG&E, Sempra, and SDG&E timely filed their rehearing applications on October 23, 2002. SCE, PG&E, and SDG&E all alleged that the Decision violates the prohibition against after-the-fact reasonableness reviews, in violation of Water Code §80110. SCE further argues that the Decision: 1) is impermissibly vague regarding utility's financial responsibility for gas tolling requirements and fails to assess the impact imposing payment responsibility would have on Edison's creditworthiness; 2) imposes unreasonable timetable to negotiate a commercially acceptable arrangement with DWR; and 3) violates ABX-6 and creates an unnecessarily complex accounting scheme with its pro rata allocation of surplus sales.

PG&E asserted that the Commission has no authority to assign operational and administrative responsibilities for the DWR contracts to the utilities without their consent. It similarly argued that the Commission does not have authority to order the utilities to assume DWR's obligations under the gas tolling provisions of the DWR contracts and to enter into contracts for gas supply thereunder. PG&E further contends that the Decision would impose an unlawful and discriminatory tax on PG&E, by compelling PG&E to assume governmental functions assigned to DWR under ABX1. PG&E was also opposed to negotiating new operating agreements with DWR on a highly compressed schedule, which it claims is fundamentally unfair and inconsistent with due process. Finally, PG&E claims that the surplus sales methodology adopted by the Decision is vague, confusing, and arbitrary.

[3] On January 7, 2003, DWR submitted a memorandum requesting modification of D.02-09-053 to include certain agreements it entered into with Madera Power, LLC, Dinuba Energy, Inc., Sierra Pacific Industries (Sonora), and Sierra Power Corporation (Terra Bella). By ruling of January 17, 2003 the Administrative Law Judge (ALJ) indicated that DWR's request would be treated as a petition to modify. The petition was granted on February 27, 2003 in D.03-02-072. That petition is beyond the scope of this Order.

Sempra concurs with PG&E that the Commission lacks authority to assign operational and administrative obligations under the DWR contracts to the utilities. It maintains that such assignments may subject DWR to breach of contract claims, and violates the Contract Clause of the U.S. and California Constitutions. Sempra also claims that the Taking Clause is violated.

SDG&E asserts that the Decision is unlawful if it requires SDG&E and the other utilities to be contracting parties for tolling agreements in connection with DWR power purchase contracts because there are no findings or conclusions to justify this requirement and there is no record evidence. It also claims that requiring utilities to be contracting parties for gas supplies to serve DWR agreements violates PU Code §454.5 and AB1X.

On November 7, 2002, DWR submitted a Memorandum to the Commission responding to the Application for Rehearing of Decision 02-09-053. DWR's Response was limited to arguments that Sempra made in its rehearing application.

On December 19, 2002, the Commission issued D.02-12-069, adopting the Operating Order under which PG&E, SDG&E, and SCE would perform the operational, dispatch, and administrative functions for DWR's long-term purchase contracts as of January 1, 2003. On December 20, 2002, PG&E and SDG&E executed and submitted Operating Agreements with DWR. On April 3, 2003, in D.03-04-029 (Decision on Motions to Approve Operating Agreements), the Commission approved, with modifications, Operating Agreements between PG&E and DWR, and SDG&E and DWR. PG&E and SDG&E were directed to file, by means of the advice letter process, revised Operating Agreements with DWR accepting the modifications set forth in that decision. PG&E accepted the Commission's modifications in its advice letter filing, and will no longer be subject to the Operating Order. SDG&E did not fully accept the modifications with its advice letter filing of April 17, 2003, but has since modified the advice letter to accept the Commission's modifications. Therefore, PG&E and SDG&E are no longer

subject to the Operating Order. SCE remains subject to the Operating Order since it never filed a jointly proposed Operating Agreement with DWR.[4]

III. DISCUSSION

A. The Commission Has Not Exceeded Its Authority in Adopting the Reasonableness Standards in D.02-09-053.

In their rehearing applications of the Contract Allocation Decision, the utilities asserted that the Decision violates Water Code §80110 and PU Code §454.5 by imposing after-the-fact reasonableness reviews of utility administration of DWR contracts. (SCE, pp. 3-7; SDG&E, p. 14; PG&E, pp. 3-4.) They operate under the premise that the Commission has no authority to engage in reasonableness review of the DWR revenue requirement.[5] The utilities rely on Water Code §80110, which provides that "any just and reasonable review under [PU Code] Section 451 shall be conducted and determined by the department [DWR]." Their theory is that the Commission is precluded from conducting any reasonableness review of DWR costs, actions or revenue requirements associated with DWR's power supply contracts. We disagree.

The Decision affirms that the Commission may not conduct after-the-fact reasonableness reviews of DWR contract terms. In so doing, it cites §454.5(d)(2), which also specifies that the Commission may establish a process to review DWR contract administration:

> (2) Eliminate the need for after-the-fact reasonableness reviews of an electrical corporation's actions in compliance with an approved procurement plan. However, the commission may establish a regulatory process to verify and assure that each contract was administered in accordance with the terms of the contract,

[4] The Commission declined to require SCE to enter into an Operating Agreement with DWR, although it was receptive to reviewing a mutually agreeable Operating Agreement between SCE and DWR so long as the terms did not substantially deviate from the terms in D.02-12-069, or D.03-04-029. (D.03-04-029, *mimeo*, p. 35.)

[5] SCE made many other allegations that do not allege or establish legal error. For example, its complaint regarding the Decision setting an unreasonable timetable for the utilities to negotiate a commercially acceptable arrangement with DWR is contradicted by the fact that PG&E and SDG&E were able to reach such operating agreements with DWR for Commission approval.

> and contract disputes which may arise are reasonably resolved.

D.02-09-053 clearly states: "We confirm that the reasonableness of DWR contract terms, quantities and prices are not subject to reasonableness review by this Commission…."[6] The Commission recognizes that AB1X limits its role with respect to determining the justness and reasonableness of DWR's revenue requirement, but "it does not limit the Commission's ability to regulate the utilities." (Decision, *mimeo*, p. 55.)

Notwithstanding the acknowledgment that DWR, not the Commission, may conduct reasonableness review of DWR contracts under §451, the Decision does not accept the notion that the Commission lacks authority to review the actions of the utilities regarding their administration of the DWR contracts. Accordingly, the Commission further disagrees with the argument that the Commission "could not review the reasonableness of DWR's, or DWR's agents', administration of the DWR contracts, and so cannot review the utilities' administration of the DWR contracts either [footnote omitted]."[7] Consistent with AB1X, the Commission does have the authority to review the utilities' administration of the DWR contracts.

The Commission further elaborated on this issue in D.02-12-069 by stating: "[W]e reaffirm that, consistent with AB1X and our direction in D.02-09-053, the reasonableness of the contracts themselves will not be at issue in this proceeding. To the extent there is any confusion, we clarify that it is only the utility's administration of the DWR Contracts that will be subject to our review."[8]

The utilities and the Commission have different interpretations of procurement legislation, particularly AB 57 §1(d), which states that it is the Legislature's intent to:

> (d) Direct the Public Utilities Commission to assure that each electrical corporation optimizes the value of its overall supply portfolio, including Department of Water

[6] Decision, *mimeo*, p. 51, fn. 64.

[7] *Id.*, p. 53.

[8] D.02-12-069, *mimeo*, p. 56.

> Resources contracts and procurement pursuant to Section 454.5 of the Public Utilities Code, for the benefit of its bundled service customers.

Consistent with this language, the Commission views AB 57, §1(d) as linking §454.5 to the Commission's legislative mandate to optimize overall supply portfolios, including DWR's.[9] In fulfilling this mandate, the Commission is required to review the reasonableness of the utilities' administration of the DWR contracts, and require the utilities to perform least-cost dispatch to optimize existing resources and reduce costs to ratepayers. The utilities opine that Commission's reliance on the introductory language in AB 57 is misplaced because SB 1976 was signed after AB 57, and therefore superseded it. We disagree with the utilities' interpretation of the rules of statutory construction, for the reasons demonstrated in a subsequent portion of this discussion.

The utilities give no recognition to the latter portion of PU Code §454.5(d)(2), which authorizes the Commission to establish a regulatory process for verifying contract administration. This latter portion provides the Commission with continuing oversight of contract administration. Consequently, the Commission retains the right to review the management of the contracts and may disallow costs to the extent that they result from ongoing practices that are not prudent. (See D.02-10-062, Standard 4.) This is not hindsight reasonableness review. The Commission cannot disallow contracts on the grounds that the original terms and conditions were not just and reasonable, or that the initial transaction was not prudent. Nor, pursuant to D.02-02-051 (the Rate Agreement Decision), can the Commission deny DWR recovery of its reasonable costs.[10] In other words, the Commission may not engage in traditional reasonableness review of DWR contracts, but may review on an ongoing basis, the utilities' administration of those contracts.

PG&E purports not to understand why the Decision found that the Commission's reasonableness review will be pursuant to §454.5, and not §451. The

[9] Decision, *mimeo*, pp. 54-55.

[10] D.02-02-051, *mimeo*, p. 55. Rehearing of D.02-02-051 was denied in D.02-03-063.

§454.5 process established in this Decision allocates costs between ratepayers and shareholders, but has no impact on DWR revenues. Under §454.5, the Commission has the authority to check for compliance with approved procurement plans. The utilities' procurement plans, after adoption by the Commission, eliminate the need to conduct traditional reasonableness review of the utilities' procurement activities. The Commission will conduct compliance reviews to evaluate utility compliance with their approved plans; it is not a traditional review of "reasonableness." The compliance review is pursuant to §454.5, and not §451. Compliance with the adopted procurement plans will be reviewed as a whole in the annual procurement proceedings, where the reasonableness of the utilities' administration of the DWR contracts will be evaluated.

The §454.5 process is distinctly different from the reasonableness review that Water Code §80110 authorizes DWR to do under §451 for its revenue requirement. As explained in the Decision, "DWR will continue to review its revenue requirement per Water Code Section 80110 and Public Utilities section 451, and will continue to submit its revenue requirement to this Commission and recover that revenue requirement per the Rate Agreement Decision."[11]

B. The Utilities' Objection to AB 57 Is Based on Statutory Misinterpretation.

PG&E and SCE argue that the Commission attempted to evade the prohibition on reasonableness review of DWR contracts by unlawfully applying AB 57 to the administration, operation and dispatch of those contracts. The utilities' objection to AB 57 is based on a misunderstanding of the rules of statutory construction. They assert that the application of AB 57 is unlawful because AB 57 was superseded by SB 1976, which was signed after AB 57.[12] An integral part of the utilities' theory is that the introductory language of AB 57 is a general expression of legislative intent and cannot as

[11] Decision, *mimeo*, pp. 55-56.

[12] AB 57 and SB 1976 were approved and signed by the Governor on September 24, 2002. The statutes are nearly identical, with AB 57 allowing the utilities 90 days to file a procurement plan after the Commission has adopted one, while SB 1976 limits the time to 60 days.

a matter of statutory interpretation, override the explicit provisions of §454.5(d)(2). Even if AB 57's introductory language were applicable, they argue, the general requirement to optimize the utility's supply portfolio, including DWR contracts, does not justify reasonableness review by the Commission because the specific provisions of the Water Code control over the more general statements of legislative intent.[13] They are simply mistaken.

The assertion that AB 57 §1(d) is a general expression of legislative intent that cannot override the explicit provisions of §454.5(d)(2), even if generally true, is not dispositive. The statutory rules of construction "are 'merely aids to ascertaining probable legislative intent.' [Citation.] No single canon of statutory construction is an infallible guide to correct interpretation in all circumstances."[14] Such is the case here. As the following discussion shows, the court will be guided by legislative intent and a duty to harmonize conflicting statutes, rather than the rigid application of statutory rules.

The primary goal of statutory interpretation is to determine legislative intent in order to effectuate the statute's purpose.[15] Without question, the procurement statutes were designed to extricate DWR from the business of procuring energy for the retail customers of the electric utilities. That is evidenced in part by the termination of DWR's authority to do so as of January 1, 2003, pursuant to ABX1-1 and Water Code §80260.[16] The Legislature therefore enacted a framework for the Commission to oversee the administration, operation and dispatch of the DWR contracts, pursuant to §454.5, so that the utilities could resume procuring electricity for their retail customers.

[13] PG&E Rhg. App., p. 3, 7-10; SCE Rhg. App. , p. 5.

[14] *Droeger v. Friedman, Sloan & Ross* (1991) 54 Cal.3d 26, 50; *City of Huntington Beach v. Bd. of Admin.* (1992) 4 Cal.4th 462, 468.

[15] *People v. Murphy* (2001) 25 Cal.4th 136, 142; *People v. Cruz* (1996) 13 Cal.4th 764, 774-75.

[16] Water Code §80260 provides that DWR's authority to purchase electricity and sell it to the utilities' retail customers expires on December 31, 2002.

Another key principle of statutory construction is that a statute must be construed to promote, rather than defeat, the statute's purpose and policy.[17] The overall purpose of the procurement legislation is to extricate DWR from the business of procuring power for the utilities' retail customers, and restore that function to the utilities where it properly belongs. The utilities would nullify this purpose by eliminating the legislative mandate that requires the utilities to optimize the value of their overall supply portfolios, including the DWR contracts, for the benefit of ratepayers.

Additionally, there is a fundamental duty to harmonize statutes on the same subject:

> 'Even when one statute merely deals generally with a particular subject while the other legislates specially upon the same subject with greater detail and particularity, the two should be reconciled and construed so as to uphold both of them if it is reasonably possible to do so [citations].'[18]

The utilities failed to harmonize AB 57 and SB 1976. Contrary to their arguments, AB 57 and SB 1976 are not irreconcilable or inconsistent. Both AB 57 and SB 1976 promote the Legislature's intent to remove DWR from the business of procuring power for the retail customers of the electric utilities, and to restore that function to the electric utilities so that they may fulfill their obligation to serve those customers. AB 57 §1(d)'s language favoring the optimization of overall supply portfolios requires the utilities to perform least-cost dispatch that is consistent with optimizing existing resources and benefiting ratepayers by reducing costs. Both bills add identical versions of §454.5 to the PU Code; however, SB 1976 changed the time period between the Commission's adoption of a procurement plan and the electric utility's resumption of procurement from 90 days to 60 days. With the exception of the obvious conflict in the number of days, statutes on the same subject can and should be harmonized, consistent with state law. Therefore, both statutes should be given effect to the extent that there is no conflict.

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[17] *Garcia v. McCutchen* (1997) 16 Cal.4th 469.

[18] *People v. Squier* (1993) 15 Cal.App.4th 235, 240-241. Accord *Medical Bd. of Calif. v. Superior Ct. of Sacramento* County (2001) 88 Cal.App.4th 1001, 1014. Garcia, *supra*, 16 Cal.4th 469, 478.

In sum, the Commission's reliance on AB 57 §1(d) and §454.5(d)(2) for reviewing utility administration of DWR contracts is legally sound. All the rules of statutory interpretation must bow to legislative intent. Conflicting statutes must be harmonized, if at all possible, giving effect to both statutes in order to implement legislative purpose.

C. The Utilities' Claims of Error Stem from a Misunderstanding of the Statutory Scheme and Confusion About the Roles of DWR and the Commission.

Some of the allegations made against the Decision result from a misunderstanding of the statutory scheme, as well as confusion about the roles of DWR and the Commission. AB 1X, signed by the Governor on February 1, 2001, adds Division 27 to the Water Code, and also adds and amends certain provisions of the PU Code. The Act provides DWR with authority to purchase electric power on behalf of retail customers of the electric utilities. DWR's authority to enter into new contracts expired on January 1, 2003, but it could continue administering contracts executed prior to that date (Water Code §80260). DWR retains legal title to the DWR contracts and is financially responsible for paying all contract-related bills. (Water Code §80110) Pursuant to the same statute, "any just and reasonable review" of the revenue requirements designated to pay for DWR's power purchases "shall be conducted and determined by the department." The Act allows DWR to enter into contracts with electric utilities to collect money owed to DWR for power that it sells to the electric utilities' customers. The Act also provides that, at the request of DWR, the Commission shall order the companies to undertake such activities (Water Code §80106). AB 1X authorizes DWR to recover its power costs from electric charges established by the Commission and entitles DWR to recover its revenue requirement from electric charges established by the Commission (Water Code §80110).

The Commission and DWR have distinct roles under AB 1X and as implemented by D.02-02-051 (the Rate Agreement Decision). In D.02-12-069, the Commission clarified those roles. In a nutshell, DWR recovers its costs through a

revenue requirement that it submits to the Commission. DWR is responsible for calculating its revenue requirement and for submitting it to the Commission. The Rate Agreement establishes the process whereby DWR recovers its revenue requirement from the customers of the utilities.[19] DWR is entitled to receive in electric rates its bond costs, power procurement costs, and other costs listed in Water Code §80134. DWR has exclusive authority to conduct any review of the justness and reasonableness of the costs it seeks to recover in electric rates under PU Code §451 (Water Code §80110).

Under Water Code §80110, PU Code §451 and §701, the Commission has broad authority to devise ratemaking mechanisms to recover the revenue requirement that DWR communicates to the Commission. The Commission has sole authority to establish the procedures it will use to set electric charges and to allocate DWR's revenue requirement among service areas and electric customers. AB 1X, the PU Code and the Rate Agreement provide the Commission with exclusive authority to allocate DWR's department costs and bond-related costs, and to set rates to recover those costs. (D.02-02-051, Conclusion of Law No. 37.)

Pursuant to PU Code §454.5, the Commission has the responsibility to "specify the allocation of DWR power to be included in each utility's procurement plan." The Commission has the exclusive authority to review the utility's administration of the contracts as part of the utility's portfolio of resources under §454.5.[20] It will review the administrative costs for DWR contracts in the context of overall administrative cost levels to determine the need for any rate increases to base rates. Recovery of the utilities' administrative costs associated with DWR contract allocation, including the gas tolling requirements, will be addressed in each utility's general rate case, where the Commission will also consider the administrative costs associated with non-DWR contracts.

[19] The central feature of the Rate Agreement was the irrevocable commitment by the Commission under PU Code §840 et seq., to set charges for electricity sold by DWR that would recover DWR's power-related and bond-related costs.

[20] D.02-12-069, *mimeo*, p. 14.

D. Assignments

1. The Commission Has the Authority to Assign Operational and Administrative Responsibilities for the DWR Contracts to the Utilities.

PG&E and Sempra assert that the Commission has no authority to assign to them operational and administrative obligations under the DWR contracts. PG&E claims that the Commission is violating Cal. Civ. Code §1550 by doing so without its consent.[21] These arguments are baseless.

PG&E claims the cases it cited "frame the scope of the Commission's authority for the purpose of analyzing the forced assignment issue." (PG&E Rhg. App., p. 5.) Those cases are *Pacific Telephone* (1950) 34 Cal.2d 822, 824 and *General Telephone* (1983) 34 Cal.3d 817. Both cases address the "invasion of management rationale" on which PG&E relies. This gist of this rationale is that the Commission is not empowered to invade management's domain, including prescribing the terms of utility contracts and substituting its judgment as to what is reasonable for that of management. The "invasion of management rationale" is widely discredited, and PG&E's reliance thereon is unpersuasive.

PG&E concedes that *Pacific Telephone's* "invasion of management rationale" was limited by *General Telephone*. In *General Telephone*, the utility challenged the Commission's power to order it to implement competitive bidding procedures to procure certain switching equipment. The utility sought to purchase outmoded equipment from a subsidiary of its parent corporation, which the Commission determined was a cause of substandard telephone service and was financially wasteful. The utility argued that the method of procuring the switching equipment was a management decision beyond the Commission's power to regulate. The California Supreme Court rejected this argument, reasoning that the Commission's order was intended to improve customer service and to pry the utility away from its dependence on

[21] California Civil Code 1550 provides that a contract requies the parties' mutual consent. Cal. Civ. Code 1550 (West 1975.)

antiquated equipment supplied by the utility's affiliate. The Court further found that "the 'management invaded' pejorative has little application in the area of 'direct consumer-utility contact'," since 'the major purpose of the order concerning competitive bidding…was better service for the consumer, rather than an officious desire to run General's business, Pac. Tel. is not applicable." (*General Telephone, supra*, p. 827.)

After *General Telephone*, the Court further questioned the vitality of the "invasion of management rationale." (*Stepak v. Am. Tel. & Tel.* (1986) 186 Cal.App.3d 633, 644-645.) In so doing, the Court noted the erosion of the rationale in several post-*Pacific Telephone* decisions, including *Southern Pac. Co. v. Public Utilities Comm'n* (1953) 41 Cal.2d 354, 367-368. PG&E's attempts to rehabilitate the "invasion of management rationale" are of no avail since the cases on which PG&E relies do not provide the necessary support.

Sempra framed its assignment argument in such a way as to link it to breach of contract claims, as well as alleged violations of the Contract and Taking Clauses of the U. S. and California Constitutions.[22] In addition, Sempra asserts that DWR may be subject to breach of contract claims if the Commission assigns DWR's administrative and operational functions to the utilities. This claim is sheer speculation since Sempra is arguing over a hypothetical situation that may never happen. Furthermore, Sempra fails to explain why it has standing to complain about DWR being subjected to breach of contract claims. DWR is an independent state agency with sufficient legal expertise to address any such claims, if they occur.

PG&E and Sempra have misinterpreted AB X1 in efforts to bolster their arguments. PG&E asserts that AB X1 limits the Commission's authority over DWR's contracts and any contractual arrangements DWR enters into with the utilities. Sempra contends that the Commission lacks statutory authority to assign to the utilities operational and administrative obligations under the DWR contracts because AB1X authorizes only DWR to administer its power purchase contracts and §454.5 only permits

[22] Alleged violations of the Contract and Taking Clauses are addressed in a subsequent portion of this decision.

the Commission to allocate the electricity provided by DWR under those contracts. These interpretations are misguided. Furthermore, Sempra points to no specific provision of ABX1 that allegedly prohibits anyone other than DWR from administering the power contracts.

As a preliminary matter, it may be a matter of semantics as to whether the Commission is assigning anything to the electric utilities, or simply allocating administrative and operational responsibilities to the utilities in accordance with AB X1 and PU §454.5.[23] Sempra's preference for using "assignment" is geared toward the cases it used to support its argument. However, those cases are inapposite because they involve personal services that require special skills. Sempra affirms the special skills requirement in *Knipe v. Barkdull* (1966) 222 Cal.App.2d 547, where it quoted: "[w]here a contract calls for the skill, credit or other personal quality of the promisor, it is not assignable." (Sempra Rhg. App., p. 7, citing *Knipe v. Barkdull*, *supra*, p. 551.) No special skills as found in personal service contracts are required for the performance of DWR's side of the contracts; therefore, the cases Sempra cited do not apply.

Contrary to the utilities' position, AB X1 gives the Commission authority to order the utilities to assume the administrative and operational responsibilities for DWR's contracts. Under AB X1, as specified in Water Code §80106(b), the Commission has authority to order utilities to 'transmit' or 'distribute' DWR power, and to provide 'billing' and 'collection' services to DWR. This statute specifically provides as follows:

> (b) At the request of the department, the commission shall order the related electrical corporation…to transmit or provide for the transmission of, and distribute the power and provide billing, collection, and other related services, as agent of the department, on terms and conditions that reasonably compensate the electrical corporation for its services.

Because Water Code 80106(b) contains no literal reference to "dispatch," "operation," or "administration" of DWR contracts, PG&E suggests that it excludes these

[23] Indeed, the Commission has used the term interchangeably. In D.02-12-069, in referring to the requirement that DWR retain title to DWR power contracts, we stated that it was not a bar to the "allocation" of operational control, rather than an "assignment." (D.02-12-069, *mimeo*, p. 13.)

functions and claims there is nothing in AB X1 or the record that would authorize the Commission to compel a utility to accept assignment of administrative, operating or other responsibilities. (PG&E Rhg. App., p. 5.) Again, PG&E is mistaken. An administrative agency is not restricted to the literal provisions of a statute in enforcing the clear mandate of the statute. (*Ford Dealers Assn. v. Dept. of Motor Vehicles* (1982) 32 Cal.3d 347.) *Ford Dealers* involved a challenge by a car dealers' association to five regulations promulgated by the Department of Motor Vehicles (DMV).[24] One such regulation (Reg. B.404-03, Dealer Added Charges) was designed to prevent a specific kind of misleading statement. In response to Ford Dealers' argument that the regulation went beyond the scope of the statute, the court responded: "An administrative agency is not limited to the exact provisions of a statute in adopting regulations to enforce its mandate. '[The] absence of any specific [statutory] provisions regarding the regulation … does not mean such a regulation exceeds statutory authority… [Citations.]'." (*Ford Dealers* at p. 362.)

In sum, the meaning of a statute or regulation may not be determined from a single word or lack thereof. Literal construction should not prevail over the intent of the regulation. (*Peltier v. McCloud River R.R. Co.* (1995) 34 Cal.App.4th 1809.) Whether or not "dispatch," "operation," "administration," or any particular word, appears is not dispositive. It is eminently clear that "[t]he intent [of the statute or act] prevails over the letter [of the act] and the letter will, if possible, be so read as to conform to the spirit of the act.' [Citation]." (*Id*., p. 1816)

Moreover, Water Code §8108 further authorizes the Commission to "issue rules regulating the enforcement of the agency function…, including collection and payment to the department." The utilities, as limited agents of DWR, are obligated to abide by the rules the Commission sets forth to fulfill the agency function.

Consistent with our policy mandate, we believe that allocating administrative and operational responsibility to the utilities is a means of ensuring that they optimize

[24] In *Ford Dealers,* the trial court declared the regulations invalid and granted an injunction against their enforcement. Ford Dealers and the DMV appealed the order invalidating the regulations. The California Supreme Court ruled that the trial court erred in finding the regulations invalid and in granting an injunction.

their portfolios. In the Contract Allocation Decision, we noted that AB 57, §1(d) confers responsibility on the Commission to "assure that each electrical corporation optimizes the value of its overall supply portfolio, including Department of Water Resources contracts and procurement pursuant to Section 454.5 of the Public Utilities Code." (Decision, *mimeo*, pp. 53-54.) We believe that allocating administrative functions to the utilities is an efficient, cost-effective way of serving customers, and is consistent with the least cost dispatch policy that undergirds our procurement decisions.

Sempra also asserts that the Decision is contrary to the terms of the DWR contracts, suggesting that the Decision breaches the non-assignment clause in the DWR contracts. As carefully quoted by Sempra in its rehearing application, the non-assignment clause states that "neither Party shall assign this agreement or its rights hereunder without the prior written consent of the other Party…." (Sempra Rhg. App., p. 6.) This clause is binding on the parties to the contract. It says nothing about the Commission, and is not binding on the Commission. Implicitly recognizing that the Commission is the "wrong party" against which to lodge a claim, Sempra turns to DWR by stating that "DWR cannot do indirectly, by way of a Commission order or otherwise, that which it is forbidden to do directly under the terms of its long-term contracts. (*Id*., p. 7.) Where a Commission order is involved, DWR is not the actor; the Commission is the actor. Each is a separate and independent agency, and Sempra does not explain how one agency can be charged for the acts of the other. Any claim that the Commission has breached the utilities' contracts with DWR is not legally viable.

2. The Decision Does Not Violate the Contract and Taking Clauses of the U.S. and California Constitutions.

Sempra's argument that compelling the utilities to assume operational, dispatch and administrative functions under the DWR contracts is a violation of Contract Clause of the U.S. Constitution and California Constitutions is no more convincing than the breach of contract claim.[25] Sempra relies on *In re Seltzer* (9th Cir. 1996) 104 F.3d

[25] The Contract Clause provides that "no state shall…pass any…Law impairing the Obligation of

234, 236 to support its argument. In this case, the issue was whether the retroactive application of a Nevada statute allowing debtors to exempt Individual Retirement Accounts (IRAs) from bankruptcy violates the Contract Clause. The bankruptcy court and the district court concluded that although the statute impaired private contract rights, the impairment was justified to achieve a valid public purpose. The Ninth Circuit agreed that the statute served a valid public purpose, was a reasonable exercise of the state's power, and therefore affirmed. If there were any impairment of Sempra's contract rights, which Sempra has failed to establish, such impairment would be dwarfed by the substantial public purpose of restoring procurement obligations to the utilities so that they may fulfill their obligation to serve the public. Rather than support Sempra's case, *Seltzer* detracts from it.

As to the alleged violation of the Taking Clause of the U.S. Constitution, Sempra's claim is similarly without merit.[26] The cases Sempra cited do not support its claim of a government "taking" of contract rights without just compensation. For example, Sempra relies on *Connolly v. Pension Benefit Guaranty Corp.* (1986) 475 U.S. 211. In this case, the U.S. Supreme Court found unanimously that although a contractual provision had been nullified, there was no violation of the Taking Clause of the Fifth Amendment, in part because the government had taken nothing for its own use and had only nullified a contractual provision by imposing an obligation that was otherwise within its power to impose. The Commission has the authority to order the utilities to assume the operational, dispatch, and administrative functions under the DWR contracts. There has been no violation of the Taking Clause of the U.S. or California Constitutions.

Contracts." (U.S. Const., art. 1, §10, cl. 1.

[26] The Fifth and Fourteenth Amendments prohibit the taking of private property for public use without just compensation. (U.S. Const., Amend. V.)

3. PG&E's Claim that the Decision Violates the Prohibition Against the Unlawful Imposition of Taxes Is Erroneous.

PG&E contends that the Decision's requirement that it assume key portions of DWR's responsibilities under the DWR contracts is beyond the Commission's police power authority under AB X1, and the Commission's attempts to force those responsibilities onto PG&E amounts to an imposition of unlawful taxes. PG&E asserts that "[t]he California Legislature has enacted no other legislation [other than Water Code §80200(c), levying a tax on PG&E or other California utilities to pay for DWR's costs of operating, dispatching and administering its power contracts under AB X1." (PG&E Rhg. App., p. 15.) It further states that compelling the utilities to assume these "governmental" functions directly, on behalf of DWR, is a violation of the California Constitution's prohibitions against the unlawful imposition of taxes."[27]

This is a novel theory, but one wholly without merit. PG&E provided no proof that the Decision exceeds the Commission's police power under AB X1, or in general. Apart from AB X1, the Commission retains the authority to exercise its police power in the regulation of public utilities. (*Southern Pac. Co. v. PUC* (1953) 41 Cal.2d 354, 367.) PG&E ignores entirely the Commission's constitutional mandate to regulate California public utilities, or the raft of legislation promulgated by the Legislature delegating to the Commission specific responsibilities for overseeing the restoration of energy procurement back to the utilities so that they may fulfill their obligation to serve their customers. In addition, PG&E and the other utilities are obliged to "obey and comply with every order, decision, direction, or rule prescribed by the commission…in any way relating to or affecting its business as a public utility." (PU Code §702.) Facilitating the restoration of procurement responsibilities back to the utilities falls within this category.

[27] The gist of this argument is that since DWR's administrative and operating costs are subject to appropriations by the Legislature, these are "governmental" functions; therefore, the costs are intended to be recovered from general revenues subject to legislative appropriation under Water Code §80200.

4. The Gas Tolling Requirements

SCE and SDG&E expressed concerns regarding the gas tolling requirements of the Decision, particularly the imposition of financial responsibility. The Commission clarified in D.02-12-069 that DWR will retain legal and financial responsibility for gas and related services, and the utilities will perform the administrative and operational activities as a limited agent of DWR. (D.02-12-069, *mimeo*, pp. 27-28, explaining Exhibit B (Fuel Management Protocols) of the Operating Order.) Since DWR will have continuing legal and financial obligations, the Commission believes it is appropriate for DWR to review the utilities' Gas Supply Plans. As to gas purchasing, DWR's involvement should be limited to the review of the Gas Supply Plans and, after Commission approval of the plans, the utilities should be free to negotiate and present agreements for DWR execution without subsequent DWR approval.

SDG&E does not assert that it is unlawful for the Commission to require it and the other utilities to administer tolling arrangements for DWR contracts. Rather, SDG&E raises the issue "that the decision appears to classify the role of being the entity that enters into contracts with gas suppliers [fn omitted] as an 'administrative' function, and thus one that the utilities including SDG&E must assume in 2003 and after." (SDG&E Rhg. App., p. 4.) D.02-12-069 affirmed that, consistent with the principles adopted in D.02-09-053, "the utility's operational and administrative responsibility for DWR contracts should extend to the implementation of gas tolling provisions (p. 48)." (D.02-12-069, *mimeo*, p. 27.) This shifting of responsibility back to the utilities furthers the goal of extricating DWR from day-to-day procurement activities.

In addition, SDG&E states that D.02-09-053 is unlawful because it does not contain findings and conclusions to justify the requirement that the utilities be the contracting parties for gas supplies for DWR power contracts. SDG&E states further that "SDG&E understands its application for rehearing to be generally consistent with Sections II and IV of SCE's Application for Rehearing of D.02-09-053 filed on October 16, 2003." (SDG&E's Rhg. App., p. 2.) Therefore, we incorporate our analysis of SCE's arguments to our response to SDG&E's rehearing application.

However, SDG&E departs from SCE's arguments in asserting that the Decision contains no findings and conclusions about whether requiring the utilities to be the contracting parties for gas supplies would impair the utilities' creditworthiness, in alleged violations of PU Code §1705 and §1757.[28] SDG&E asserts that the Commission is required by §454.5 to adopt findings as to whether its adopted procurement plan would impair the restoration of creditworthiness, or lead to a deterioration of a utility's existing creditworthiness. SDG&E misreads §454.5, particularly §454.5 (c), which provides as follows:

> (c) The commission shall review and accept, modify, or reject each electrical corporation's procurement plan. The commission's review shall consider each electrical corporation's individual procurement situation and shall give strong consideration to that situation…the commission may not approve a feature or mechanism for an electrical corporation if it finds that the feature or mechanism would impair the restoration of an electrical corporation's creditworthiness or would lead to a deterioration of an electrical corporation's creditworthiness.

When D.02-09-053 was issued, the Commission had not adopted any utility procurement plan. Therefore, it was premature to charge the Commission with failing to adopt findings on whether "its adopted procurement plan" would impair restoration of creditworthiness when no such plan had been adopted. SDG&E's argument linking the "lack" of findings to "lack" of substantial evidence fails both because SDG&E misreads the statute and because it is premature. Neither §1705 nor §1757 has been violated.

SCE challenged the gas tolling requirements from the point of view that they are vague and the Decision does not assess the impact on its creditworthiness of requiring the utilities to assume financial responsibility for the gas tolling requirements. SCE claims that forcing it to assume payment responsibility for DWR's gas contracts that would be repaid at a later time would violate §454.5(c). Without specifically mentioning Conclusion of Law No. 9, SCE further objects to the Commission's requirement that

[28] Section 1705 provides that a decision shall contain separately stated findings of fact and conclusions of law on all issues material to the order or decision. Section 1757(a)(4) provides in pertinent part that a decision of the Commission shall be annulled by a reviewing court if "the findings in the decision of the commission are not supported by substantial evidence in light of the whole record."

DWR should reimburse the utilities for their reasonable gas procurement costs.[29] In effect, SCE is arguing for the reimbursement of unreasonable costs, the rejection of which is so obvious as not to require further elaboration.

The claim by SCE that §454.5 (c) would be violated was speculative and premature when SCE filed for rehearing. SCE complains about a theoretical situation that may never happen, yet it is conjuring up a dooms-day scenario of "what ifs." Furthermore, SCE never submitted a procurement plan for the Commission to approve or reject.[30] In the Operating Order Decision, the Commission has taken all due consideration of SCE's creditworthiness. In addition, the Operating Order made certain modifications to Fuel Management Protocols in Exhibit B of the Operating Order, and corrected a discrepancy between the procedures for paying gas invoices in Exhibit B and the procedure described in D.02-09-053. Ultimately, D.02-12-069 adopted payment procedures for paying gas invoices found mutually acceptable by the parties and specified in Section X and XIV of Exhibit B.[31]

E. The Utilities' Complaints About the Surplus Sales Methodology and the Corresponding Accounting Scheme Do Not Establish Legal Error.

PG&E and SCE attacked the surplus sales methodology adopted by the Decision. PG&E claims that the surplus sales methodology is vague, confusing, and arbitrary. It asserts that the pro rata allocation approach is not simple, and the Commission should consider replacing the surplus sales revenue allocation requirement with a more workable approach. SCE alleges that the surplus sales methodology adopted

[29] D.02-09-053, Conclusion of Law No. 9 states as follows: "Requiring that the utilities administer the gas purchases for contracts with gas tolling provisions is as legally permissible as requiring that the utilities administer the other aspects of the DWR contracts. As discussed in this decision, DWR should reimburse the utilities for their reasonable gas procurement costs."

[30] SCE did not execute an Operating Agreement with DWR, and therefore remains subject to the Operating Order. The Commission declined to require SCE to enter into an Operating Agreement with DWR. (D.03-04-029, *mimeo*, p. 35.)

[31] Exhibit B's purpose is to describe and define DWR's and the utilities' specific responsibilities regarding management of the DWR contracts directly related to supplying gas to generators.

in the Decision violates ABX-6 and creates an unnecessarily complex accounting scheme. PG&E endorses this view. The utilities' arguments are unpersuasive.

ABX-6 amends PU Code §377 to read as follows:

> The commission shall continue to regulate the facilities for the generation of electricity owned by any public utility prior to January 1, 1997, that are subject to commission regulation until the owner of those facilities has applied to the commission to dispose of those facilities and has been authorized by the commission under Section 851 to undertake that disposal…The commission shall ensure that public utility generation assets remain dedicated to service for the benefit of California ratepayers.

SCE contends that the Commission violates §377 "by allocating a portion of the production from utility retained generation assets to surplus sales on the wholesale market, rather than allocating that power to serve the needs of the utility's own customers." This statement is the sum and substance of SCE's allegation regarding the alleged violation of §377. SCE's statement, without further elaboration, violates PU Code §1732 and Rule 86.1 of the Commission's Rules of Practice and Procedure. A rehearing application must specifically set forth the grounds on which the applicant considers the decision to be unlawful, and the applicant is cautioned against vague assertions as to the law. SCE's allegation failed to meet these criteria. In footnote 6 on page 14 of its rehearing application, PG&E incorporates by reference the apparent violation of §377. Nothing further is said about it. We incorporate by reference our analysis of this allegation to dispose of PG&E's argument that we violated §377.

The surplus sales methodology is not perfect; however, the Commission believes it is the most equitable way to determine the relative amounts of retail and surplus sales revenues between DWR and the utilities. Therefore, the Commission has determined that it is the preferred way to allocate sales revenues. It is within the Commission's discretion to do so, and it is not legal error. The pro rata allocation approach calculates surplus energy sales and revenues from an integrated utility portfolio by:

(1) calculating the amount of surplus sales based on the excess of total utility portfolio resources (including DWR contracts allocated today) relative to loads,

(2) allocating those sales revenues between DWR and the utilities based on the relative quantities dispatched from utility resources and the DWR contracts, and

(3) calculating the revenue from retail customers using the difference between dispatched quantities and the surplus sales quantities calculated under (2).

While the pro rata allocation approach is complex, the alternative is no less so.[32] The Commission deems the pro rata approach necessary to eliminate the incentive that the utilities would have to favor their own generation over DWR contracts.

PG&E and SDG&E complain about the "complex accounting scheme" used to allocate the proceeds from surplus sales between the utilities and DWR. The accounting protocol prescribed in the Decision is needed to implement the allocation of surplus sales on a pro rata basis. It is not legal error for the Commission to adopt this approach, notwithstanding its complexity. In the Operating Order Decision, the Commission clarified the definitions related to surplus sales, and provided guidance regarding how the Commission will review the utilities' actions with respect to surplus sales. (See D.02-12-069, *mimeo*, pp. 31-42.)

IV. CONCLUSION

We have carefully considered all the allegations in the rehearing applications by Pacific Gas and Electric Company, Southern California Edison Company, Sempra Energy Resources, and San Diego Gas & Electric of D.02-09-053, and do not find legal error. Accordingly, we deny rehearing.

[32] An alternative would be to try to establish a precise hourly dispatch order along with hourly loads and compare the two to allocate revenues depending on where each resource falls in the lineup. This process is no less complex, but may arguably be more precise.

Therefore, **IT IS ORDERED** that:

1. The rehearing of D.02-09-053 is denied.

This order is effective today.

Dated June 19, 2003 at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners